

ST 95-4

Tax Type: SALES TAX

Issue: Use Tax on Purchases, Fixed Assets, or Consumables

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
ADMINISTRATIVE HEARINGS DIVISION
COUNTY OF SANGAMON

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DEPARTMENT OF REVENUE OF THE      )
STATE OF ILLINOIS                  )
                                   )   Docket #   XXXXX
                                   )   IBT #      XXXXX
      v.                            )
                                   )
XXXXXX                             )
                                   )
      Taxpayer                      )
                                   )   Karl W. Betz
                                   )   Administrative Law Judge
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RECOMMENDATION FOR DISPOSITION

APPEARANCES: XXXXX, for the Taxpayer.

SYNOPSIS: This case involves XXXXX, a corporation that did business in Illinois during the audit period by operating several pizza restaurants under the name XXXXX.

A hearing was convened, pursuant to Notice before the Illinois Department of Revenue, and the Taxpayer contested certain findings made by the Department Auditor after an audit of the company's books and records for the period October 1, 1989, through December 31, 1992. Upon completion of the audit, the auditor reviewed his findings with a representative of the Taxpayer who stated the company would not agree with the audit findings at that time. In accordance with the pertinent provisions of the Illinois Use and Retailers' Occupation Tax Acts, the auditor did cause to be issued a Correction of Returns. This corrected return was the basis of Notice of Tax Liability XXXXX issued XXXXX, for XXXXX, inclusive of tax, penalty, and interest.

At issue is the percentage of consumable purchases by Taxpayer that are entitled to the resale deduction. The Department established

additional use tax liability upon the basis that 18.6 percent of Taxpayer's sales are take-out, that is, consumed off the premises. The Taxpayer asserts additional exemption from use tax on the basis that its take-out sales during the audit period constituted 69.38 percent of its total.

XXXXXX, testified on behalf of the Taxpayer and referenced Taxpayer Exhibits 1 through 4. XXXXXX, also testified for the Taxpayer. XXXXXX, the Revenue Auditor who conducted the audit, gave rebuttal testimony for the Department.

After reviewing the record, including all documentary evidence and testimony submitted by Taxpayer, I find the issue should be resolved partially in favor of the Taxpayer and partially in favor of the Department.

FINDINGS OF FACT:

1. The Department conducted a Retailers' Occupation and Use Tax Audit of the Taxpayer's business for the period October 1, 1989, through December 31, 1992. (Tr. 7-8).

2. During the audit period, Taxpayer was engaged in the restaurant business where it sold pizzas of varying sizes and related items such as salads and beverages. (Department Exhibit No. 1).

3. The audit was conducted in order to verify the amounts of taxable receipts and purchases reported by Taxpayer on its monthly sales tax returns. (Department Exhibit No. 1).

4. A 12 month test-check of the Taxpayer's purchase invoices was used by Auditor XXXXXX in extrapolating the amount of use tax liability upon consumable supplies and upon the paper and packaging materials. There was a separate and different 12 month test-check period used for testing general consumable supplies and for checking purchases of paper napkins, cups, wrapping materials and related items. Because the test-check procedure was agreed to by both the Department and Taxpayer (Tr. 58-

59, Department Exhibit No. 1, audit file page 128), this negates the argument Taxpayer offered at the hearing that certain purchases should be excluded from the use tax extrapolation on the grounds they were "one time" in nature.

5. The auditor, based upon the best available evidence, comprised of the Taxpayer's records showing a 18.6 take-out percentage for sales for its two Ohio restaurants, reached the determination that additional use tax was due by Taxpayer for the audit period. (Department Exhibit 1).

6. Based upon the documentary evidence presented at the hearing, the take-out percentage (both delivery and carry-out) of Taxpayer's trade for the audit period is 39.86%. (Taxpayer Exhibits Nos. 1-4).

CONCLUSIONS OF LAW: Illinois Statutes impose a tax upon the privilege of using tangible personal property within Illinois. (35 ILCS 105/3). The Use Tax Act defines the term "Use" as the exercise of ownership power over tangible personal property, such as the pizza pans, boxes, paper cups and other items purchased by Taxpayer in this matter. (35 ILCS 105/2). However, the Use Tax Act exempts tangible personal property which is purchased for resale.

Title 86 Ill. Adm. Code Sec. 130.2070 (c)(4) states:

"Sales of paper napkins, drinking straws, paper cups and paper plates to restaurants (including drive-in restaurants) and other vendors of food or beverages for use on the premises as serving equipment in lieu of more durable kinds of serving equipment (such as linen napkins, metal drinking straws, glass or porcelain cups and plates) are taxable retail sales. Sales of paper napkins, drinking straws, paper cups and paper plates to food or beverage vendors are nontaxable sales for resale if the items are resold for a direct and specific charge, or if the items are employed as containers for food or beverages contained therein and are transferred with the food or beverages to the purchaser thereof either by being delivered by the food or beverage vendor away from his premises to his customers or by being delivered on the premises of the food or beverage vendor to customers who take the packaged food or beverages away from such premises with them for consumption elsewhere (i.e., the so-called "carry-out trade"). In general, it may be assumed that paper sacks, boxes, cartons and paper cups with lids, when sold to a food or beverage vendor, are for resale within the meaning of this paragraph. The

same is true of paper cups which are used in serving beverages or other tangible personal property from a vending machine."

This regulatory section means that the paper napkins, pizza boxes, straws, cups and other items used by Taxpayer's customers on the restaurant premises are used in lieu of more durable goods and therefore are subject to Illinois Use Tax. This includes the paper or cardboard boxes in which single slices were served to customers. The portion of the same items that are carried out by the customers or accompanied pizzas delivered by Taxpayer personnel to customers off the premises, are not subject to Use Tax on the basis of the resale exemption. See *Sta-Ru Corporation v. Mahin*, (1986), 64 Ill. 2d 330.

It is the position of Taxpayer that its percentage of take-out sales is 69.38%. (Taxpayer Exhibit No. 1, p. 15). To derive this percentage, Taxpayer supplied documentary evidence from its major supplier (Taxpayer Exhibit No. 3) that shows the number of pizza boxes sold by the supplier to Taxpayer, and this is divided according to the different box sizes. Taxpayer also submitted the number of each type of pizza sold from its computer data base (Taxpayer Exhibit 2) and computed a percentage of out-of-store sales from this data. However, the data used in the calculation for the small, heavyweight, medium and large pizzas was a 12 month period, but for the individual slices sold, only two months were used. To be statistically and mathematically valid, the slice units (SL) sold must be annualized in making this calculation. When this is done, the total annual portion of Taxpayer's sales that are take-out is calculated to be .398607916 as follows:

PIZZA TYPE	TOTAL UNITS SOLD	TAKE-OUT BOXES USED	TOTAL ANNUAL PERCENTAGE
SM	27,717	16,400	
HW	20,251	18,400	
MD	32,995	26,800	
LG	51,083	40,400	
SL	*1,496,592	*547,188	
	1,628,638	649,188	39.8607916

*ANNUALIZED

By using their take-out percentage of 69.38, Taxpayer recalculated its Use Tax Liability to be \$26,342.90. (Taxpayer Exhibit No. 1, pp. 4-14). Taxpayer witnesses also testified that certain items purchased could only be used in its take-out trade and consequently should be totally excluded from tax. These changes were incorporated in the individual line items shown on pages 6-14 of Taxpayer Exhibit 1. As noted above, I cannot agree with the use of the 69.38 percent because it represents a skewed calculation. Using the weighted average take-out percentage of 39.86, the amount of Use Tax for which Taxpayer is liable is recalculated to be \$38,977.00. In making this computation, I have accepted the exclusion by Taxpayer, of the items they maintain are exclusively for out-of-store use with the exception of the peanut glassine envelopes. This is because on rebuttal testimony, Mr. XXXXX stated that he personally observed these items being used both for on premise usage, as well as carry-out (Tr. 54). Taxpayer's witness then explained how these peanut glassines had been used both ways until sometime in 1992. Based upon this, I recommend using the take-out percentage of 39.86 for these items until the last work sheet entry for the final five months (Taxpayer Exhibit 1, p. 12) where I would allow the full 100 percent exclusion as resale. After making these adjustments, the 10/1/89 - 12/31/89 base amount is \$50,917.00 with Use Tax due of \$2,545.85, the 1/1/90 - 7/31/90 tax base amount is \$71,186.00 with Use Tax due of \$4,449.13, the 8/1/90 - 7/31/91 tax base amount is \$95,076.53 with Use Tax liability of \$5,942.28, the 8/1/91 - 7/31/92 tax base amount is \$109,059.21 with Use Tax liability of \$6,816.20, and the 8/1/92 - 12/31/92 tax base is \$45,524.67 with Use Tax liability of \$2,845.29. This covers all paper and other items Taxpayer purchased from its major supplier. Taxpayer also purchased other general consumable supply items and these are recomputed by Taxpayer on the premise that it is

liable on \$10,748.58 of the tax base found by the auditor, but that certain items for promotional purposes were one time purchases that should be excluded from the extrapolation. Taxpayer also prorated certain plastic cups and lids in this category between on-premises and off-premises consumption, and excluded entirely certain plates and pans for extra large and heavy duty pizzas.

Based upon the evidence, I will accept the part of Taxpayer's recalculation where they exclude 100 percent of heavy duty plates. I also recommend using the 39.86 take-out percentage for the plastic cups and lids here.

I cannot agree with the exclusion from the projection of the promotional name tags, sunglasses, T-shirts and other items, because Taxpayer signed a test-check agreement wherein it agreed for the consumable supplies to be sampled for this audit period. (Fact 4). The use by the auditor of a sample test for consumable supply Use Tax liability is proper when Taxpayer does not object, and this Taxpayer agreed with the procedure. The rationale for auditing a sample on a test-check basis is to examine transactions that are representative of the entire population in order to save time and audit work for both parties. While Taxpayer testified that they did not purchase similar items in the subsequent year, they have not produced all their purchase invoices for the entire audit period to establish that these items were actually a one time purchase, and Illinois case law has consistently held that mere oral testimony is not sufficient to overcome the Department's prima facie case which consists of the introduction of its corrected return into the record. (Department Exhibit 1).

Using the revised take-out percentage and accepting the exclusion of the heavy duty plates and extra large pizza pans, the consumable supply Use Tax liability for 1/1/90 - 12/31/92 is calculated to be \$7,821.71, and for

10/1/89 - 12/31/89 is calculated to be \$521.45.

In summary, I recommend the Final Assessment incorporate these recommended recalculations.

RECOMMENDATION: Based upon the above findings of fact and conclusions of law, I recommend the Department reduce Notice of Tax Liability XXXXX and issue a Final Assessment.

Karl W. Betz
Administrative Law Judge